

TAX EXTENDERS AND SMALL BUSINESSES AS EMPLOYERS OF CHOICE

HEARING BEFORE THE SUBCOMMITTEE ON ECONOMIC GROWTH, TAX AND CAPITAL ACCESS OF THE COMMITTEE ON SMALL BUSINESS UNITED STATES HOUSE OF REPRESENTATIVES ONE HUNDRED FOURTEENTH CONGRESS FIRST SESSION

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THURSDAY, DECEMBER 3, 2015

HOUSE OF REPRESENTATIVES,
COMMITTEE ON SMALL BUSINESS,
SUBCOMMITTEE ON ECONOMIC GROWTH,
TAX AND CAPITAL ACCESS,
Washington, DC.

The Subcommittee met, pursuant to call, at 10:00 a.m., in Room 2360, Rayburn House Office Building. Hon. Trent Kelly presiding.
Present: Representatives Kelly, Chabot, Huelskamp, Radewagen, and Chu.

Mr. KELLY. Good morning. I call this hearing to order.

I would like to start by thanking the witnesses, especially the small business owners who have traveled here from different parts of the country, for being here today.

Being a small business owner in America is a tough job. No matter what your business, you must wear many different hats. In addition to doing what you went into business for in the first place, you probably have to tackle responsibilities as a tax accountant, advertising executive, regulations expert, fund-raiser, and human resources expert as well. Yet, throughout history, entrepreneurs in America have done all these things and more. One of the things that is critical for small business owners is finding, attracting, and retaining qualified employees. To find success in today's global economy, companies know that creative, adaptable, and engaged employees are a critical asset, and while recent surveys show that Americans hold small businesses in high esteem, at a rate of three times higher than big businesses, small firms still have to aggressively compete with firms of all sizes to fill out their rosters. To win this war for talent, firms know that they must become employees of choice so that their organizations can bring together the best individuals to work on the challenges and opportunities of a new and ever-changing economy. Increasingly, these small businesses have expanded the traditional benefits they offer prospective employees in the face of greater competition for talent.

We have had small firms testify before our committee in the past that offer new benefits that small firms would not traditionally offer, such as flex time packages with greater work-home balance, wellness programs with financial incentives, or bonuses with stock options and profit-sharing arrangements. But the competition is not always fair. Sometimes, small business owners' ability to compete for talented employees can be hindered by federal regulatory or statutory action, or in some cases, inaction.

One area of particular importance is tax policy. Most small businesses find it difficult to stay current on tax laws because so many tax revisions are temporary. Effective only for a few years or even months, and regularly extended, these provisions, commonly referred to as “tax extenders” leave small business owners guessing about their tax liabilities each year. This is in contrast to large firms that often have tax attorneys and accountants on staff to help them get a better grasp of their tax liability in any given year. While they dislike the uncertainty the extenders provide, most small firms welcome the extension of these provisions because they result in lower tax bills and provide opportunities for them to invest in their businesses. Among the most popular are bonus depreciation, section 179 expensing, and the research and experimentation tax credit.

I suspect that our witnesses today will give us ideas as to what they would like to see in the extenders package. I am looking forward to hearing your thoughts.

Again, I want to thank all of you for taking the time to testify before us today. I now yield to our ranking member, Ms. Chu, for her opening statement.

Ms. CHU. Thank you, Mr. Chair. And thank you all for being here today.

As we approach another last minute extension of various tax provisions, it is critical that we continue our efforts to strengthen small business by putting certainty back into our tax code. We all know that failure to take any action creates greater uncertainty and in the end hurts our small businesses who provide two out of every three new net jobs in our country. This hearing today will give the Committee the opportunity to examine just how useful tax extenders are to small business and why their temporary nature creates great challenges.

Section 179 expensing remains one of the most essential tax provisions for small employers in all industries. It is an invaluable tool which provides benefits to small firms by giving them bigger immediate write-offs, reduced paperwork and money to invest back into their businesses. It also serves as a spark to the economy as money saved now is injected back into the marketplace.

While small businesses primarily utilize and benefit from the enhanced section 179 expensing provisions, several other extender provisions are critical to small firms. One such incentive is the research and experimentation credit, the R&D credit. Although this tax credit is a source of frustration for many taxpayers due to its temporary status and complex rules, it has reduced business costs for new research by as much as 7 percent. But most importantly, over 70 percent of the benefits from the credit are attributable to high-paying, domestic, research-based job salaries.

With the end of the year fast approaching, the nation’s fiscal health is on the minds of many Americans, especially small business owners, and as a member of this Committee, I am well aware of the challenges created by the Internal Revenue Code and the major obstacles that uncertainty has on business growth. We cannot pass another retroactive extension that applies only to the 2015 tax year. This singular focus does not help our nation’s job creators; instead, it hinders their ability to plan for the future and harms

the overall economy. We depend on these businesses to spur economic growth by expanding operations, but they cannot do this without the existing tax incentives they have come to rely on. These provisions are critical for small businesses, and it is also critical that we implement these extensions in fiscally responsible manners.

The primary way to achieve this goal is through comprehensive tax reform. Long-term reforms will encourage small entities to make purchases now and in years to come. Providing this certainty helps put money back in the pockets to invest and hire now.

I would like to thank the witnesses for their participation today, and I look forward to their testimony. I yield back.

Mr. KELLY. If Committee members have an opening statement prepared, I ask that they be submitted for the record.

I would like to take a moment to explain the timing limits for you. You will each have 5 minutes to deliver your testimony. The light will start out as green. When you have 1 minute remaining, the light will turn yellow. Finally, at the end of your 5 minutes it will turn red. I ask that you try to adhere to the time limit.

And with that said, now I will introduce the witnesses. I will do all of you and then I will let the ranking member introduce her witness.

Our first witness is Jason Duff, founder and CEO of Bellefontaine Ohio Properties, a development firm that purchases and remodels storefront buildings in Bellefontaine, Ohio. The firm then works to attract, recruit, and start new businesses in the community. In addition to his real estate business, Jason is also a third generation business owner, working for his family-owned enterprise, Ohio Ready Mix. He is a regular advice contributor to INC., Forbes, and Entrepreneur magazines, and is testifying on behalf of the Small Business Entrepreneurship Council. Thank you for being with us today, Mr. Duff.

Up next will be Todd Kriegel, CEO of Global Precision Parts, Inc., or GPP. A family-owned business, GPP has three locations in the Midwest with approximately 200 team members. The company sells into the automotive light truck, plumbing, heavy truck, HVAC, tube fabrication, hydraulic, and munitions industries. Testifying on behalf of the Precision Machine Products Association, Todd serves on their Government Affairs Committee and Board of Directors. We appreciate your participation today, Mr. Kriegel.

Our next witness is Rich Shavell, president of Shavell and Company, a CPA and consultation firm based in South Florida. The company serves contractors of all sizes with financial statement, tax, and consulting services. Rich is a long-time member of the Associated Builders and Contractors where he has served as chair of the National Tax Advisory Group and chair of the Legislative Committee of ABC's Florida East Coast Chapter. He has also served as chair of the Construction Financial Management Association National Tax and Legislative Affairs Committee. He is testifying on behalf of the Associated Builders and Contractors today. Thank you again, Mr. Shavell.

I yield to Ms. Chu for the introduction of Mr. Nichols.

Ms. CHU. It is my pleasure to introduce Mr. Thomas Nichols, an attorney and partner at Meissner Tierney Fisher and Nichols. This

firm is over 160 years old and the second oldest firm in Wisconsin. Mr. Nichols also serves as the chairman of the Board of Advisors of the S Corporation Association, and recently served as chair of the S Corporation's Committee of the ABA section of Taxation. Mr. Nichols, thank you for joining us today.

Mr. KELLY. I now yield 5 minutes to Mr. Duff for your opening statement.

STATEMENTS OF JASON DUFF, FOUNDER AND CEO, BELLEFONTAINE OHIO PROPERTIES, LTD.; TODD KRIEGEL, CEO, GLOBAL PRECISION PARTS, INC.; RICH SHAVELL, CPA, CVA, CCIIFP, PRESIDENT, SHAVELL & COMPANY, P.A.; TOM NICHOLS, ESQ., ATTORNEY AND CHAIRMAN OF THE BOARD OF ADVISORS OF THE S CORPORATION ASSOCIATION, MEISSNER TIERNEY FISHER & NICHOLS S.C.

STATEMENT OF JASON DUFF

Mr. DUFF. Good morning, Chairman Kelly, Ranking Member Chu, and members of the Subcommittee. Thank you for the invitation to provide testimony today on the important issue of strengthening the nation's small businesses.

My name is Jason Duff, founder and CEO of Bellefontaine Ohio Properties. I am a third-generation family business owner and have founded several companies of my own. I started my first business when I was 8 years old, selling candy bars. In my earlier years, I have also sold custom greeting cards, made-to-fit shoes, stamps, coins, and even Beanie Babies.

Bellefontaine Ohio Properties purchases and remodels storefront buildings on Main Street. We attract, recruit, and start new businesses in our community. To date, I have purchased and renovated 14 different historic buildings in our downtown. My passion is to build and grow smart, vibrant, and entrepreneurial communities. Bellefontaine Ohio now has a multitude of diverse stores and businesses due to the revitalization efforts. These businesses are a gourmet pizza shop, baker, hair salon, CrossFit gym, several new antique stores, and a brew pub. All of these have helped create our downtown having life and vibrancy. Construction has also begun at eight new loft apartments on the second story of our buildings.

Bellefontaine is an area that other communities are taking notice of in terms of our approaches and best practices to restoration. I am proud to say that our work in Bellefontaine has all been accomplished in the past 4 years.

While growing assets on our balance sheet is important, I find that our greatest asset in my company is our employees, so recruiting and hiring talented employees is a very important piece of our success. On this front, I must compete with businesses of all sizes to find talented employees I need to operate effectively and productively. I am committed to building a team of people who love their community and allow my employees flex time to run and serve in public office, volunteer with local service organizations, like Rotary and Kiwanis, and have the time they need to successfully raise their families. Providing employees with key benefits, like workplace flexibility truly make us and other small businesses an employer of choice.

Small businesses play a crucial role in the vitality of job growth in a local community like Bellefontaine. When we are healthy and growing, we are providing consistent quality and skilled job opportunities. When we invest and renovate a commercial storefront, for example, we hire local carpenters, plumbers, and electricians. Many of our renovation projects have contributed to the direct job growth in local trades. We also work with these local companies in purchasing cabinetry, flooring, and light fixtures. These investments in hiring local businesses equate to new tax dollars that benefit our municipalities, our schools, and our service organizations.

As you are aware, the key tax measure, like enhanced section 179 expensing and bonus depreciation that are part of the tax extenders have expired and were only made retroactive very late in 2014 for that year. For 2015, businesses like mine have been planning and operating under the outdated section 179 expensing level of \$25,000.

The uncertainty of bonus depreciation also affects my investment decisions. Bonus depreciation is a benefit that has influenced smart decisions for my business. I have purchased new equipment versus used equipment because of bonus depreciation, and that new equipment is more efficient, reliable, and cost effective in the long term. I believe that these investment incentives are making a positive impact in keeping small businesses competitive. With a stable and enhanced 179 provision and certainty on bonus depreciation, I am able to invest more capital in projects. Again, these projects start new small businesses that in turn provide valuable contributions to my community. These new businesses create jobs, increase property values, and grow local revenues.

Here is my basic advice for government work to work better and smarter for small business owners and encourage entrepreneurship. Make permanent the incentives, making permanent the most robust levels of the section 179 expensing, as well as bonus depreciation, will provide small businesses with practical and needed tools to grow, invest, and work harder. The type of stability and certainty is critically important. Make the tax code simpler. Simplifying the tax code would reduce complexity and costs for entrepreneurs. The more time and money we have to invest in our businesses, the stronger enterprises will become. Be clear, provide clarity to small business owners. Give us an opportunity to know and understand the rules so that we can plan and play by them for the future. Provide clear instruction so we can focus on the growth of our businesses and invest with confidence and make a long-term commitment. Businesses forecast and plan far into the future. A smart tax code would mirror effective business planning. Investment thrives when it is encouraged when there is certainty.

Thank you for the opportunity to share my experiences and my views with you today. It is truly an honor to be able to do so, and I look forward to your questions in discussion.

Mr. KELLY. Thank you, Mr. Duff.

And now I recognize Mr. Kriegel for his opening statement.

STATEMENT OF TODD KRIEGEL

Mr. KRIEGEL. Good morning. Thank you for allowing me to testify today. My name is Todd Kriegel. I am the CEO of Global Preci-

sion Parts, otherwise known as GPP, a family-owned business with 80 employees in Indiana, and 120 employees split between two facilities in Ohio.

I am here today to underscore the importance of small business manufacturing in America and call on Congress to make permanent key tax provisions which fuel our economy. We founded GPP in 1989 as a privately-held family business. I increasingly think about what the future holds for my three children manufacturing and employees working in our facilities.

Instability in the tax code prevents manufactures from planning investment, hiring more workers, and purchasing new equipment, especially for small businesses in industries with razor-thin profit margins. In the real world, we cannot simply assume Congress will retroactively extend business investment provisions and spend money we may not have at the end of the year.

I am a member of the Precision Machine Products Association, whose members flew to Washington this week to personally stress the importance of addressing these expired tax provisions. To prepare for our visit to Capitol Hill, PMPA conducted a quick survey of its members on which tax provisions they use to compete globally. Respondents average 60 employees, similar to our facilities in Ohio and Indiana, yet despite being small businesses, they invest heavily in capital equipment, expecting to spend on average \$552,000 in 2015. Most machines for our industries start at a quarter million dollars and can exceed \$2.5 million. At Global Precision Parts, to maintain a competitive edge, we continuously buy new equipment, spending roughly \$2 million each year.

Because of our capital investments, bonus depreciation is by far most important to us. In 2014, it saved our company \$151,000, money we used to hire more employees and purchase additional equipment. In the precision manufacturing industry, not only is our equipment expensive and heavy, it takes time to place into service, often 8 weeks to 18 months. Congress extending the expired provisions on December 11th does little for a small business who cannot finance, purchase, and place into service a 10-ton machine by December 31st when the provision expires again.

There is a misleading impression amongst some in Washington that bonus costs the Federal government money in lost revenue. However, the government does receive the revenue over the life of the equipment, but the provision provides smaller companies like ours an immediate discount on the price of the new machine we could not otherwise afford. The survey also showed the typical precision parts manufacturer claimed nearly \$370,000 in section 179 equipment expensing for 2014.

When Congress fails to extend this key tax provision, small businesses have a major hole to fill in their budget. This means we will cut our current year spending on new equipment and often suspend investment for the coming year. Remember, lower machine orders by companies like mine mean fewer workers are hired and less tax revenue is collected throughout the supply chain.

Inside the beltway, you may not feel the ripple effects of your inaction, but in the real world we certainly do. When we do not know what the future holds, businesses like bankers spend less, take fewer risks, and reduce or stop hiring altogether. As a responsible

business owner, I have to find a way to cover that \$150,000 gap Congress created for our company if bonus depreciation remains expired.

According to our association survey, dysfunction in Washington would cost the average small manufacturer \$600,000 if bonus depreciation section 179 and the R&D tax credit remain expired. Who is going to cover the \$600,000 tab Congress unnecessarily created? This is why we need comprehensive tax reform for all businesses. C corporations or pass-throughs, large and small, family-owned or publicly-traded. Like most family-owned companies, we are a pass-through, meaning we pay taxes at the much higher individual rate, which for us was 39.4 percent last year. If Congress lowers the tax rate only for C corporations, Washington will leave behind millions of small manufacturers like us to pay the higher taxes.

Making the expired provisions permanent and tackling comprehensive tax reform is not about paying fewer taxes. GPP's effective tax rate increased by over 11 percent between 2008 and 2014, sending hundreds of thousands of dollars to Washington rather than putting it in workers' pockets. Yes, I said workers' pockets, because at GPP last year, we reinvested 71 percent of our profits back into the business.

Uncertainty surrounding the few tax provisions intended to encourage manufacturing in America is a self-inflicted drag on growth. I believe that small businesses can continue deriving the economy; however, Congress must make permanent bonus depreciation, section 179 equipment expensing, and the R&D tax credit to allow small businesses to invest and plan for the future.

Thank you for allowing me the opportunity to testify before you today on this important issue.

Mr. KELLY. Thank you for your testimony, Mr. Kriegel.

We have House votes on the House floor, so we will adjourn for about 45 minutes and then have the next two witnesses and reconvene after the votes.

[Recess]

Mr. KELLY. Okay. We will reconvene at this time, and with that said, we now ask for the opening statement of Mr. Shavell.

STATEMENT OF RICH SHAVELL

Mr. SHAVELL. Thank you. My name is Rich Shavell, testifying on behalf of Associated Builders and Contractors, a national construction industry trade association with 70 chapters representing 21,000 members. I am president of Shavell and Company, a full service CPA and consulting firm that focuses on services to closely-held commercial contractors.

The subject of this hearing is very appropriate as small businesses, in fact, the employer of choice for the average American, not only within the commercial construction industry but throughout the U.S. economy.

Small businesses, and particularly small contractors, are excellent employers for several reasons. First, there is plenty of work in commercial construction because we are facing a severe labor shortage. Secondly, training is available for new workers to the industry. According to the ABC Institute in South Florida, the value of being a graduated registered apprentice is worth \$300,000 addi-

tional dollars during the career of the typical worker. Moreover, the construction industry fosters the realization of the American dream. Through effort and determination, many construction workers find themselves picking up small jobs, working them with their peers afterhours and on weekends. Anecdotal evidence suggests that seasoned workers can earn significant amounts of money this way until they are ready to leave their regular position to pursue their own businesses on a full-time basis. The single biggest challenge facing small business today is widespread uncertainty and specifically, uncertain federal tax policies are chipping away at these small businesses' ability to effectively operate.

From my perspective there are two main tax issues. First, Congress must do its job and pass tax legislation to stabilize the tax environment. The continual expiration of effective dates for tax incentives and other tax provisions included in the Annual Extenders Bill hurts the business community, and particularly the small business. Right now, as we are approaching the end of the year, contractors have to project and plan for their 2015 tax liabilities, yet it is unknown whether the tax extenders will even be in the law.

Second, for commercial contractors, Congress should finally rectify certain tax provisions that are hurting these small contractors.

In 1986, Congress passed legislation that was intended to curb abuses by aerospace and defense contractors and how they, these large businesses, utilize the completed contract method. The required use of the percentage of completion method was forced upon all businesses who perform work under long-term contracts. To address this burden, a small contractor exception was put in place in 1986 with a \$10 million revenue threshold. Almost 30 years later, that threshold has never been updated.

For comparison, Small Business Administration currently utilizes a threshold of \$36.5 million. We continue to ask Congress to do three things to address this. First, update the small contractor threshold from \$10 million to \$40 million. Second, index the threshold going forward. And thirdly, eliminate the section 56(a)(3) addback requirement for alternative minimum tax purposes, for AMT tax purposes. This third item would eliminate the requirement that is currently law, that revenues from long-term contracts we reported under the percentage of completion method solely for AMT purposes. So even though they have the small contractor exception, they still have to use percentage of completion solely for AMT. And a further horrific result is that the small contractor today is required to go through complex computations under the lookback method solely for AMT purposes. By eliminating this AMT adjustment, this ridiculous lookback requirement would be eliminated for so many small businesses.

In summary, Congress must do its job by adding permanency to the tax system, and thereby, provide certainty for small businesses, including contractors. Moreover, it is time for Congress to rectify the wrong that was done in 1987 whereby commercial contractors are still saddled with complex tax requirements that were not even intended to impact them. It is time to make that right.

Thank you.

Mr. KELLY. At this time, I would like to recognize our chairman, Mr. Chabot, who has now shown up for the entire Committee, and

with that said, I now yield to our ranking member, Ms. Chu, for the introduction of our next witness.

Ms. CHU. Well, I did introduce him earlier. So, but I hope that you can just testify now.

Mr. KELLY. I am sorry. Mr. Nichols, at this time, if you will give us your opening statement.

STATEMENT OF TOM NICHOLS

Mr. NICHOLS. Thank you very much.

Chairman Kelly and Chairman Chabot, Ranking Member Chu, thank you very much for asking me to testify today.

I am a member and past chair of the ABA Tax Sections Committee on S corporations, and I am currently chairman of the Board of Advisors of the S Corporation Association. I have been representing closely-held businesses since 1979.

There are many issues that divide members of Congress, but fortunately, the role Main Street businesses play in creating jobs is not one of them. Everybody understands that closely-held businesses create most of the new jobs and employ the majority of the private sector workforce; what is less known is the role of startup businesses in this success. As the Kauffman Foundation has made clear, without startups there would simply be no net new job creation. We need startups to grow the jobs base. The challenge for policymakers is that business startup activity has declined sharply in recent years. To help reverse this trend, there are a number of bipartisan steps that Congress could take to ensure these businesses resume their critical role as a source of jobs, innovation, and growth. I will briefly describe four of them.

First, Congress needs to stop retroactively adopting the so-called "extenders." Many of these provisions are of critical importance to small business and their retroactive adoption at the end of the year creates unnecessary hardship for business owners. For example, I have spent considerable time over the past several years answering the question of whether the 5-year or the 10-year recognition period for built-in gains tax will apply. The only response I could give is that it will probably be 5 years, but that clients cannot count on it. This has created a number of difficulties. Several of my farming clients, for example, wanted to sell while farmland prices were at their peak. Unfortunately, those in the critical 6- to 10-year limbo period were unable to commit to sale absent a sale absent congressional action, and now it appears that the optimal time for selling may be gone. This makes no sense. Built-in gains relief and other business extender provisions are clearly good policy and should be made permanent.

A second, unforced error is section 409A. It imposes rigid guidelines for deferred compensation plan, violation of which triggers substantial penalties on employees, even though the corresponding tax deduction to their employers has also been deferred. Section 409A creates an unnecessary impediment to offering employees deferred benefits. In our practice, we have had to restate phantom stock plan documents in order to comply with these new rules, while some of our clients have simply decided to forgo offering deferred compensation at all.

This provision represents such poor policy that the full American Bar Association Tax Section has come out against it.

Third, the Affordable Care Act is being implemented in a way that has serious negative consequences for even employers with less than 50 employees. The IRS has taken the questionable position that the HRAs and other employer plans that reimburse individual policies somehow run afoul of the market reform provisions of the ACA. This contorted position is particularly burdensome for small, closely-held businesses. One client at a longstanding HRA that provided generous reimbursement for premiums on health insurance policies selected by the individual employees, his employees like the plan and so did he, but they just could not keep it. In fact, I understand that the NFIB has estimated that 16 percent of small businesses are in violation of this provisions.

The penalties of running afoul of this questionable position are draconian. A small employer with only 10 employees could face a penalty of \$365,000 in any given year. There is bipartisan legislation to correct this interpretation, and I urge you to accelerate the passage of this bill, perhaps as part of the extenders legislation.

Fourth, the IRS has adopted comprehensive regulations relating to the capitalization of capital expenditures, including a safe harbor for expenditures of \$500,000 or less. This is good policy, but it only applies to taxpayers who have so-called applicable financial statements, such as those required by the SEC. Entities that do not have these statements get a much lower standard of just \$500. That includes many, many closely-held businesses. This unfairness should be corrected as part of the upcoming extender package as well.

These are just four areas where Congress could act in a bipartisan way to help Main Street businesses create and maintain good jobs. Once again, I would like to thank the Committee for holding the hearing and inviting me to testify. We sincerely appreciate all your efforts to fix these and other unnecessary burdens small businesses face.

Mr. KELLY. At this time, I recognize myself for 5 minutes to ask questions to the panel.

During the past 6 years or so, the number of business deaths has outpaced the number of business formations, and we have discussed that quite a lot in our Committee this year. In other words, more businesses are failing each year than are being created. This is a big problem. Do you any of you feel that the increasingly complicated nature of the tax code has played a role in the number of business deaths that we have seen in recent years?

Mr. Duff?

Mr. DUFF. Entrepreneurs inherently are risk-takers. They are people that believe or have ideas, and they want to go out to the marketplace and try to solve that problem. But as regulations increase, as things become more confusing and difficult to understand, their ability to stomach that risk is challenged, and at some point I see in my work on Main Street some people just throw their hands up and give up. I believe by us working to make some of these provisions permanent, specifically the section 179 deduction, it gives businesses that certainty so they can plan and they can

speak and inspire other entrepreneurs to take a leadership role in opening new businesses.

Mr. KELLY. Anyone else?

Mr. NICHOLS. Certainly.

Mr. KELLY. Mr. Nichols?

Mr. NICHOLS. There is no question that the complexity and even the delayed complexity where they are balancing not only the issue of a very complicated set of rules, but also whether or not those rules will apply and how they will apply. There is no question that it has a dampening effect. It is the equivalent of being told you might have cancer. Yes, technically, you can do everything you could have done before, but at the end of the day, you do not really know and it is going to slow down your long-term thinking.

Mr. KELLY. Mr. Kriegel, you talked a little bit about the nexus of access to financing and tax liability in your written testimony. Could you talk a little more about the interplay between certainty in the tax code and assessing financing and capital you need in your line of business?

Mr. KRIEGER. Sure. I would be happy to.

So, obviously, you complete budgets that are 5 or 10 years out so that you know what your expenses are going to be. With these tax extenders, not knowing at the end of the year whether we are going to have to fill \$150,000 or \$250,000 hole, those are dollars that we necessarily do not have laying around. So, in my opinion, that just, for future years, that minimizes the investments that you are going to make, and you have got to readjust your budget constantly.

Mr. KELLY. Thank you.

And Mr. Duff, if there were to be an extenders package passed next week, could you realistically take advantage and make a snap decision, get something ordered, delivered, and installed in time to get the tax break?

Mr. DUFF. When we pass laws that retroactively impact the previous year in such a short timeframe, it makes it very difficult to be able to plan and make intelligent decisions. The work that we do in purchasing buildings that have been vacant for 30 years, and recruiting new businesses to occupy and fill them, there is a lot of equipment and needs that need to be purchased, but there is a lot of planning that has to happen. So making sure that we provide provisions that are clear and give us a runway to plan throughout the future would help relieve some of those problems.

Mr. KELLY. Thank you.

And Mr. Shavell, in the past, we have had witnesses that have said that some small business tax incentives, such as the Small Business Healthcare Tax Credit established in Obamacare are not worth the time. Have you found this to be the case when working with small firms? And how does this contrast provisions like section 179 or bonus depreciation?

Mr. SHAVELL. Well, there is a lot in these extenders, and some of them are small, but some of them are important, too. And not just to the commercial contractors that we represent, but also to the families of the workers. I mean, you start right at the top of the list there and you see the deduction for state and local, state taxes, very important to everybody in Florida where we do not have

the state income tax. I have clients whose spouses are teachers. They look for that small amount every year as an adjustment.

The other bigger items that have been mentioned here already, section 179, bonus depreciation, things like that, are very important to small businesses. Anybody who is paying a little more tax than they should have, they do not like it, whether it is a small item or a big item. But let me give you an example of that section 179 where this is really important this year. I have a particular client who purchased equipment last year, 2014. He purchased to the max, but because of other requirements in the code, he could not get the entire benefit, so he has a carryover, six digit carryover of section 179 deduction that we let carry over because we anticipated income in this year, in 2015. He is now faced with a \$25,000 threshold, and that is incongruent with the intent. He did what was expected. He utilized the incentive in 2014. He may not get the full benefit in 2015. We are going to have to relook at that.

Mr. KELLY. Thank you very much. My time is expired.

I next recognize the ranking member, Ms. Chu.

Ms. CHU. Thank you, Mr. Chair.

I would like to address this to anyone on the panel, starting with Mr. Nichols. Of course, one of this Committee's goals is providing business owners with certainty when it comes to taxes. We have talked about the problems of retroactivity and lack of permanency, but what if Congress does not reach a deal on tax extenders at all this month? Can you talk about how this would affect your business's decisions to expand, hire workers, or make business investments?

Mr. NICHOLS. Obviously, as I indicated earlier, it has an unavoidable consequence, and the uncertainty alone has a huge impact. And there are clearly many businesses that have, since these things have been extended over the years, there are many businesses that frankly have gone forward on the assumption that they will, in fact, be extended. There are other situations, for example, the built-in gains tax. I have got a client literally this year that I said to him, "Well, if you sell your business, the built-in gains tax will probably be 5 years." He is in that limbo period, and I am communicating with him and I say, "But what I would do is I would get all the paperwork ready to go, but why do you not wait for the extenders package gets passed?" And I got kind of a heartbreaking email back from him saying, "Well, I cannot wait. I have got health problems. I will not be able to do that." These are very real situations and the lack of certainty, and especially in a context like that, where they really do have to make a decision. They cannot delay. Critical for a small business.

Ms. CHU. Yes?

Mr. KRIEGER. In business there are so many uncertainties—foreign competition, healthcare costs, trained, skilled workers—taxes should not be an uncertainty. We should know what our tax liability is going to be.

Ms. CHU. Anybody else? Mr. Shavell?

Mr. SHAVELL. Well, the question I get this time of year, every day of the week almost, because we are doing tax planning for our contractor clients, is what is going to happen? So they want to know. And they, in essence, are forced to witness something un-

usual as just mentioned. There should be some certainty; yet, I am in the position where I have to show somebody, hey, look, based on what you spent this year and the potential for extenders, your liability would be this versus here is what it is going to be if Congress does not do their job. That level of uncertainty to look at your cash flow impact and realize—because there are two parts to tax planning. Not just knowing what the number is, but when are you going to pay it? So there is an impact as to whether or not there is going to be some withholding on a bonus, whether there is going to be a fourth quarter estimated coupon on January 15th, or a larger balance due on April 15th. This impacts daily cash flow, this uncertainty, and it is really unfortunate.

Ms. CHU. Okay, Mr. Nichols, any time we consider renewing tax incentives, one of the driving principles is cost. Two of the most expensive provisions are the ones small businesses rely on the most, section 179 and the R&D credit. What role should budget neutrality play in our efforts to extend these tax incentives permanently?

Mr. NICHOLS. I am stumbling a little bit because that is an area obviously that you are more—Congress is more on the frontlines in terms of making those decisions, but the budget neutrality, obviously, is important. But unfortunately, budget neutrality can have some negative impacts sometimes. Sometimes in order to achieve budget neutrality there are other provisions that are put in place to offset the budget cost of particularly good provisions. And I would submit that, like, 409A would be one of those provisions that I think may have been put in to offset what was otherwise a good provision, but 409A, frankly, was bad policy to begin with, even though it may have purported to have raised revenue, at the end of the day it hurt maybe as much as whatever it was that it was justifying getting into the code.

Ms. CHU. Mr. Shavell, small firms often have the fewest resources to spend on accountants to identify potential tax breaks. And there are individuals and businesses that spend 6.1 billion hours a year complying with these filing requirements. How does the continuing debate about how to extend tax provisions create advantages for firms that can devote those resources to monitoring tax modifications?

Mr. SHAVELL. Well, tax compliance, as you point out, ridiculous number of hours, and there are provisions in there that are difficult. And yes, smaller companies have a great deal of difficulty complying with some of the rules. Larger firms are going to have internal counsel in a lot of cases. They are going to have more accountants on staff who are specialized in various areas, so they can take care of those things.

In the construction industry, when you talk about complexity, one of the things I mentioned in my testimony, this lookback method that affects all contractors performing long-term contracts. The amount of work and time that is required to comply is incredibly difficult. We have had conversations with IRS and folk at the IRS do not like this provisions any more than the industry does. It is something that for quite a long time needs to be removed. This lookback method, which requires taxpayers to go back and look at their contracts on a hypothetical basis. So you are looking back a

year on a hypothetical basis, recomputing what the tax would have been if you did not use estimates, then compute a hypothetical—

Mr. KELLY. If you can wrap it up pretty quick. We are past our time.

Mr. SHAVELL. So these rules are incredibly complex. Sure, larger companies are going to have a little more resources.

Ms. CHU. Thank you. I yield back.

I now recognize the chairman, Chairman Chabot, for 5 minutes.

Mr. CHABOT. Thank you very much, Mr. Chairman.

Just a couple of questions. In order of their value to small businesses, and I would ask each of the panel members if they would like to weigh in on this. Which of the various so-called tax extenders do you believe are the most important and would you most strongly encourage us to extend? And maybe we will start at this end here, if that is okay.

Mr. DUFF. Thank you. The work that I do in purchasing vacant buildings and reinvesting and recruiting new businesses to occupy them, it is very capital-intensive for the types of equipment that we have to purchase. So the section 179 provisions are extremely essential for us to continue to purchase and buy additional equipment, and the same goes with having access to bonus depreciation. Those monies keep more working capital in our business so we can actually grow our footprint in making a larger impact in our community.

Mr. CHABOT. Thank you.

Mr. Kriebel?

Mr. KRIEGER. Thank you. Companies in our industry invest significant capital, \$250,000 is kind of a minimum threshold. So from our standpoint, bonus and section 179 are very important. R&D is important, too, so really from our perspective, all three are very important.

Mr. CHABOT. Okay, thank you.

Mr. Shavell?

Mr. SHAVELL. Well, for commercial contractors, I would say there are three categories. The first category discussed is 179 and bonus. Past that, there are incentives, other depreciation rules that are very helpful because they induce investment. So you have the 15-year expensing on real property costs. You have section 179D, which is an energy deduction that is available to certain parties, whether it is the owner of the property or in some cases it is actually the contractor-designer. So that is very important. And thirdly, you have some labor-related items, the empowerment zone credits, which are pegged to wage rates as far as how much of a credit you are going to get. And also, the work opportunity tax credit. That is the old targeted jobs tax credit. So those are all valuable to commercial contractors. As far as the order goes, I would have to argue 179 and bonus are at the top, just like everybody else.

Mr. CHABOT. Thank you.

Mr. Nichols?

Mr. NICHOLS. I am going to agree with everybody and repeat 179 and bonus. In answer to your question, I am thinking in terms of how many people are impacted and the importance of the policy, 179 and bonus, for reasons set forth in more detail in my written testimony. I do not think 179 and bonus are even a tax expendi-

ture. I think it is choosing the right time to tax individuals and tax businesses when they actually are getting income from the capital that they have been spending.

I would then, as far as having a priority after those items, there you are balancing how serious of a disruption it is to the individual taxpayer versus how many people it affects. I would probably throw the built-in gains tax next, only because even though the 5-year period only affects a relatively small number of people, the pretty dramatic impact that a forced double tax built-in gains tax has for an individual owner who is trying to sell their business on retirement or something like that, I would probably throw that in there, too. And then another one that has been mentioned in that is the qualified restaurant and retail property and things like that. There again it is not as important because it does not affect a broad cross section, but for the people that it does affect, the difference between having a 15-year recovery period versus having a 39-year recovery period is huge and can have a very dramatic impact on individual, real living businesses.

Mr. CHABOT. Thank you.

I have been on this Committee for about 20 years and have talked to an awful lot of small business districts in the past in my district, but now being chair of the Full Committee, talking to folks from all over the country, and the one word that I always heard over and over was uncertainty was the biggest concern that they had, and that is what comes out of Washington. And I have only got a half minute left. Does anybody have a real world example of how this kind of uncertainty on these extenders or any other tax items is really adversely impacted or we could have done much better on something if we had just gotten it done up here? Anybody got anything in particular that they would like to bring before the Committee? Yes?

Mr. DUFF. We have empty buildings in our community that people do want to take risks. They want to invest in them, but they are uncertain. You know, there are enough uncertainties in the world and the tax consequence of knowing if this is a smart move or not is causing them to not move forward with taking that risk.

Mr. CHABOT. Okay, thank you.

Mr. SHAVELL. May I?

Mr. CHABOT. Yes, Mr. Shavell. Yes.

Mr. SHAVELL. I have a real world example. We were engaged to do a section 179D analysis for a client who has a hotel property. We started the study. We took a retainer. The client pointed out that it is not in the law yet because we are waiting for extenders. I am sitting with a retainer. We finished the project and the arrangement that was made was that while if it does not pass, we are going to give her back the retainer, and if it does pass, they are going to pay us the second piece. But the engineer that we used, he has yet to get paid, yet he has done all the work. That is a real-life example of dollars now sitting in a bank waiting to go to the service providers, and a client who does not know whether they are going to get that accelerated deduction.

Mr. CHABOT. Thank you. I yield back, Mr. Chairman.

Mr. KELLY. The gentleman's time is expired. Thank you, Mr. Chairman.

I next recognize for 5 minutes Ms. Radewagen.

Ms. RADEWAGEN. Thank you, Mr. Chairman. I want to welcome the entire panel here today.

My question is specific to my home district. I am familiar with the 30(a) style tax credits and the American Samoa Economic Development Credit. Are you aware of any other tax credits specific for U.S. territories? And if so, which of these would provide the biggest benefit for the territories?

Okay. Can you elaborate on how important these credits are for economic stability in these territories? For example, these tax credits are one of the major reasons our tuna canneries are able to operate in American Samoa, so therefore, these tax credits provide my islands employment.

Mr. DUFF. I grew up in a small town in a rural community, so I understand that a lot of—agriculture is a big thing in the middle of Ohio, and for farm families, being able to invest and purchase a combine or tractor may be the largest expense that they make. By having certainty and knowing when you are making that investment, that large piece of equipment, you will be able to grow that family business and maybe extend that or pass that on to siblings and see multi-generations of hard work actually pay off. And I think that is the American dream, and these tax credits help people achieve that.

Ms. RADEWAGEN. Thank you very much. I would appreciate if I could get a little information on my earlier question if that is possible.

Thank you, Mr. Chairman. I yield back.

Mr. KELLY. Thank you. The gentlewoman has yielded her time back.

In closing, again, I want to thank each of the witnesses for being with us. All of you provided excellent testimony, both orally and in writing, and I appreciate that.

As this Congress progresses, my colleagues and I on the Committee on Small Business will continue to work to simplify the tax code and provide small business owners the certainty they need to focus on growing their businesses instead of guessing what their tax liability will be in the coming year. In the meantime, we will share what you have shared with us today with members of the House Ways and Means Committee to help them craft a thoughtful and robust tax extenders package.

I ask unanimous consent that members have 5 legislative days to submit statements and supporting materials for the record.

Without objection, so ordered.

This hearing is now adjourned.

[Whereupon, at 12:10 P.m., the Subcommittee was adjourned.]

A P P E N D I X

**“Tax Extenders and Small Businesses as Employers of
Choice”**

Testimony of

Jason Duff

Founder & CEO

Bellefontaine Ohio Properties Limited

Before the

Subcommittee on Economic Growth, Tax and Capital Access

Committee on Small Business

United States House of Representatives

December 3, 2015

The Honorable Trent Kelly, Chairman

The Honorable Judy Chu, Ranking Member

Good morning Chairman Kelly, Ranking Member Chu and members of the subcommittee. Thank you for the invitation to provide testimony today on the important issue of strengthening our nation's small businesses.

My name is Jason Duff, Founder and CEO of Bellefontaine Ohio Properties, Ltd. As background, I am a third generation family business owner, and founder of several businesses. My grandparents and parents were small business owners. I started my first business when I was eight years old, when I sold candy bars. In my earlier years I have also sold custom greeting cards, made-to-fit shoes, stamps, coins and beanie babies.

Bellefontaine Ohio Properties purchases and remodels storefront buildings on Main Street. We attract, recruit and start new businesses in our community. To date, I have purchased and renovated fourteen different historic buildings in Downtown Bellefontaine. My passion is to build and grow smart, vibrant and entrepreneurial communities.

Bellefontaine, Ohio now has a multitude of diverse stores and businesses due to these revitalization efforts. These businesses—a gourmet pizza shop, bakery, hair salon, CrossFit gym, several new antique stores, and a brewpub, for example—have helped to give new life to downtown Bellefontaine. Construction has also begun on eight new loft apartments above the Main Street storefronts of Bellefontaine.

Bellefontaine is a community that other communities are taking note of in terms of approaches and best practices towards restoring small town Main Streets and downtown areas. I am proud to say that our work to rejuvenate Bellefontaine has all been accomplished in the past four years.

Human Capital is Our Foundation

While growing assets on my balance sheet is important, I find that the greatest asset to my company is my employees. So recruiting and hiring talented employees is a very important piece of our success.

On this front, I must compete with businesses of all sizes to find the talented employees I need to operate effectively and productively. I am committed to building a team of people who love their community and allow my employees flex time to run and serve public office, serve on local service organizations like Rotary and Kiwanis and the time they need to raise their families.

Providing employees with key benefits—like workplace flexibility—truly make us and other small businesses an “employer of choice.” In small businesses like mine, employees can more quickly learn critical and well-rounded skills, provide ideas and feedback that are more quickly implemented in operations, and in the end feel appreciated and valued by their employer. Such attributes, combined with innovative benefits, add greatly to our staying power and ability to grow.

Why the Tax Extenders are Important

Small businesses play a crucial role in the vitality of job growth in a local community like Bellefontaine. When we are healthy and growing, we provide consistent, quality and skilled job opportunities. When we invest in renovating a commercial storefront, for example, we hire local carpenters, plumbers, and electricians. Many of our renovation projects have contributed to direct job growth in local trades. We also work with local companies to purchase cabinetry, flooring and light fixtures. These investments in hiring local businesses equate to new tax dollars that benefit local municipalities, schools and service organizations.

As you are aware, key tax measures—like enhanced Section 179 expensing and bonus depreciation—that are part of the “tax extenders” have expired and were only made retroactive very late in 2014 *for that year*. For 2015, businesses like mine have been planning and operating under the outdated Section 179 expensing level of \$25,000. The uncertainty of bonus depreciation also affects my investment decisions.

Bonus depreciation is a benefit that has influenced smart decisions for my business. I have purchased new equipment vs. used because of bonus depreciation and the new equipment is more efficient, reliable and cost effective in the long term. I believe that these investment incentives are making a positive impact in keeping small businesses competitive.

I cannot tell you how important it is for my businesses, and for the economic health of my local community, that entrepreneurs and risk-takers like me have practical and stable expensing levels established so that we can invest with confidence. Being able to plan our investment strategies and opportunities will not only strengthen our businesses, but local communities and job growth as well.

My business model centers on investment in order to restore and rehabilitate buildings so they are suitable for modern businesses that customers would like to visit, and spaces that entrepreneurs can adequately compete and operate in. As noted above, this investment has helped to launch new businesses and spark a downtown micro-economy revival in Bellefontaine. Stability and certainty when it comes to investment incentives in the tax code is critical for me in terms of planning, taking risks, and moving forward with projects. For example, and as noted above, expensing allows me to confidently invest in equipment to help start new businesses and improve the efficiency and combativeness of my operations. One small example is the purchase of new freezers and coolers that are more energy efficient for our restaurants.

With a stable and enhanced Section 179 provision and certainty on bonus depreciation, I am able invest more capital in projects. Again, these projects start new small businesses that in turn provide valuable contributions to my community. These new businesses create jobs, increase property values and grow local tax revenues.

I am also able to encourage investment in areas that have traditionally been challenged by the dominance of the Internet, or large international corporations. Again, investment is central to risk-taking, growth, revitalization and competitiveness. The impact of a

permanent, enhanced Section 179 expensing provision and bonus depreciation would be powerful for my business and community. I can only imagine what the impact would be for our broader economy if all small businesses were provided the certainty of the enhanced and permanent expensing limits.

Here is my basic advice to make government work better for small business owners and to encourage entrepreneurship:

Make permanent the incentives. Making permanent the more robust levels of Section 179 expensing, as well as bonus depreciation, will provide small businesses with practical and needed tools to grow, invest and work harder. This type of stability and certainty is critically important.

Make the tax code simpler. Simplifying the tax code would reduce complexity and costs for entrepreneurs. The more time and money we have to invest in our businesses, the stronger our enterprises will become. Small businesses like mine compete with larger businesses and in a competitive global marketplace. Tax relief, simplification and certainty will boost the competitiveness of small businesses in Bellefontaine and throughout the United States.

Be clear. Provide clarity to small business owners. Give us an opportunity to know and understand the rules so we can plan for the future. Provide clear instructions so we can focus on the growth of our businesses to invest with confidence. Not only does this include clarity when it comes to taxes and tax compliance, but for all rules and regulations as well.

Make a long-term commitment. Businesses forecast and plan far into the future. A smart tax code would mirror effective business planning. Investment thrives when it is encouraged and when there is certainty.

Thank you for the opportunity to share my experiences and views with you today. It is truly an honor to be able to do so, and I look forward to your questions and our discussion.

**Written Testimony
Of**

**Todd Kriegel
CEO, Global Precision Parts, Inc.**

**Before the
Small Business Subcommittee on Economic Growth, Tax, and
Capital Access
U.S. House of Representatives**

Thursday, December 3, 2015

Thank you for allowing me to testify today about the role small businesses like us play in the economy and the impact of expired tax provisions on manufacturing companies. My name is Todd Kriegel, I am the CEO of Global Precision Parts, Inc. (GPP), a family owned business based in Ohio. I came here today to underscore the importance of small businesses manufacturing in America and call on Congress to make permanent key tax provisions which fuel our economy.

After graduating from Xavier University, I went into banking until I came back to the family business, then known as Acme Machine Automatics, Inc. Even while working for a larger regional bank, I always admired the small businesses to whom I was lending, for their unique ability to control their own destiny. I went back to manufacturing because at the end of the day, you have something to show for it and can say, "As a manufacturing company, we produced that product."

Following its creation in 1989, GPP expanded through growth and acquisition and we now have metalworking manufacturing facilities in Ottoville and East Liberty, Ohio and Wabash, Indiana. GPP is a privately held Subchapter S Corporation owned by the Kriegel family and as my three children grow, I think about what the future holds for manufacturing and the employees working at our facilities.

We have sixty employees each in Wabash and East Liberty and eighty in Ottoville, manufacturing precision parts for the hydraulics and tube fabrication industries, automotive, light and heavy truck, agriculture and mining. Our industry is certainly starting to see a leveling off in our recovery from the Great Recession of 2008–2009, when our employee numbers were half what they are today. While we are receiving more orders these days, the volume is consistently lower. However, we can succeed and compete with any

company around the world, but only if Washington does its job and lets us do ours.

Instability in the tax code prevents manufacturers from planning investment, hiring more workers, and purchasing new equipment, especially for small businesses in industries with razor-thin profit margins. As a former banker, I know the added scrutiny these companies face when financing major equipment and infrastructure investments. Today the lending market is even tighter for manufacturers as bankers try to assess our tax liabilities and downgrade our credit due to increased potential tax liabilities from expired credits and deductions. In the real world, we cannot simply assume Congress will retroactively extend business investment provisions and spend money we may not have at the end of the tax year.

I am a member of the Precision Machined Products Association (PMPA) whose members flew to Washington this week to personally stress the importance of addressing these expired tax provisions. In preparation for those visits with Senators and Representatives, PMPA conducted a quick survey of its members. The results clearly underline the role small businesses play energizing the economy and the importance of specific tax provisions on manufacturers of our size.

Respondents had an average employee size of 60, quite similar to our facilities in Ohio and Indiana. Most businesses in the precision parts industry have roughly \$12–15 million in annual revenues but as this survey shows, they invest heavily in capital equipment purchases, expecting to spend on average \$552,000 in 2015. Most machines for our industry start at a quarter million dollars and can exceed \$2.5 million. At Global Precision Parts, in order to maintain a competitive edge, we need to continuously upgrade our operation and buy new equipment, leading us to spend roughly two million dollars a year.

Among the tax provisions Congress allowed to expire, Bonus Depreciation is by far the most important to our company and to many other small manufacturers who must continuously invest in their businesses. In fact, some businesses like ours forego Section 179 Equipment Expensing because a single machine can exceed the \$500,000 cap and rely on Accelerated or Bonus. In 2014, Bonus saved our company \$151,000; money we used to hire more employees and purchase additional equipment. Bankers are very aware of these provisions as well and in recent years, manufacturers would receive notices from lenders to act quickly to finance capital expenditures before key tax provisions expired at the end of the year.

In the precision manufacturing industry, not only is our equipment expensive and heavy, it takes time to place into service, often eight weeks to eighteen months. Congress extending expired investment provisions on December 11 does little for a small business who cannot finance, purchase, and place into service a 10-ton machine by December 31 when the provision expires again.

For a typical PMPA member, the survey showed Bonus Depreciation saved them on average \$188,000 with one manufacturing business reporting a \$503,000 savings. Half a million dollars is a lot of money for businesses of our size—resources we could use to buy

another one or two machines or hire a half a dozen skilled workers with full benefits. There is a misleading impression among some in Washington that Bonus “costs” the federal government money in lost revenue. However, the government does receive the revenue over the life of the equipment but the provision provides smaller companies like ours an immediate discount on the price of a new machine we could not otherwise afford.

Were our three facilities wholly separate and not under the control of a single company, we would also benefit from Section 179, as do many of our PMPA colleagues. The survey showed the typical small business claimed nearly \$370,000 in 2014. When Congress fails to extend this key tax provision, small businesses have a major hole to fill in their budget and will cut back their current year spending on new equipment and often suspend investment for the coming year. Remember, lower machine orders by companies like mine means fewer workers are hired and less tax revenue is collected throughout the supply chain.

Although many PMPA members are contract manufacturers who do not design their own consumer end product, we still benefit greatly from our own Research and Development activities, and even more so from our customers’ R&D efforts. The typical PMPA company claimed roughly \$40,000 in 2014 in R&D Credits, with the maximum being just over \$100,000. At GPP, last year we claimed \$28,000 in federal R&D and saved another \$10,000 under the Indiana state R&D credit. Small businesses in particular are increasingly wary of R&D triggered federal and state tax audits and prefer to avoid spending \$20,000 on accountant and legal fees to defend a \$40,000 claim. However, I believe a permanent enhanced and expanded federal R&D Tax Credit will incentivize more small manufacturers to further engage in developing their own new technologies.

Inside the beltway, you may not feel the ripple effects of your inaction, but in the real world, we certainly do. When we do not know what the future holds, businesses, like investors, spend less, take fewer risks, and reduce or stop hiring all together. As a responsible business owner, I have to find a way to cover that \$150,000 gap Congress created for our company if Bonus Depreciation remains expired. Our lenders will recognize we have less cash on hand, artificially increasing the price of a new machine we could have bought.

I cannot underscore enough the importance on small businesses and our economy of these three tax provisions Congress keeps allowing to lapse. Dysfunction in Washington could cost the average small manufacturer \$370,000 in Section 179, \$188,000 in Bonus Depreciation, and \$40,000 in R&D. Who is going to cover this \$600,000 tab Congress unnecessarily created? As usual, it is America’s small businesses and their millions of employees who suffer most, not politicians in Washington or the “fat cats” on Wall Street.

The expired tax credits and deductions are only one layer to the complicated relationship small businesses have with the Internal Revenue Code. The vast majority of companies like ours are not C-Corporations but are structured as pass-through businesses, often

Subchapter S-Corporations, paying taxes at the higher individual rate. Throughout PMPA, pass-throughs make up two-thirds of our 400-member association; and in the broader economy, they account for over half of all business revenue.

We structured ourselves as an S-Corporation because, as a family owned business, it provides us flexibility in the event that my children decide to become the next generation of manufacturers. Especially as many of the original owners are considering retirement, we can develop critical succession plans that ensure the previous generation still receives some compensation for their contributions while bridging the business to the younger Americans who will serve as the backbone of our industry for years to come. Indeed, we are not alone in recognizing the advantages of a pass-through over C-Corps—the U.S. Census estimates less than six percent of all businesses today are C-Corporations.

Given these statistics on the number of pass-throughs in the country, and the clear fact that the majority of them are small businesses, I am curious why some in Washington are calling for C-Corp only tax reform. If we leave America's small entrepreneurs behind, big business wins as usual and Congress will only have themselves to blame. We need comprehensive tax reform for all businesses, C-Corp or pass-through, large and small, family owned or publicly traded. Washington must create an environment in which manufacturers cannot only compete globally but can defeat our competition.

This is not about paying less taxes, it is about the government being smarter about who it taxes and how. The top tax rate for pass-throughs is 39.6% and 44% when factoring in health care taxes, higher than 35% C-Corp rate, which Congress is considering lowering to 25–30%. Some are arguing that lowering the rates for pass-throughs will amount to a tax cut for Wall Street and pharmaceutical giants. I assure you that does not describe us nor do we have plans to reincorporate in Ireland, but do want to grow here in the U.S. if Congress lets us.

GPPs current federal effective tax rate is 39.4%, far higher than our C-Corp counterparts, not to mention the Chinese companies who we really are competing against. In 2008, we had a 28.07% effective federal tax rate with the Alternative Minimum Tax. That 11.33% jump in our tax liability cost us hundreds of thousands of dollars we could have used to hire more workers for the machines we would have purchased. Instead, we sent that money to Washington rather than putting it in workers' pockets. Yes, I said workers' because at GPP last year we reinvested 71% of our profits back into the business. When we can leave the money in the business instead of sending it to bureaucrats and politicians, it generates additional payroll and sales tax revenue as we add employees and order new machines.

I believe that small businesses can continue driving the economy and serving as the backbone of our nation. However, Washington's inaction on comprehensive reform and Congress allowing the continued expiration of key tax provisions creates a globally uncompetitive environment for small businesses manufacturing in Amer-

ica. Absent updating the Code for all companies, Congress must make permanent Bonus Depreciation, Section 179 Equipment Expensing, and the R&D Tax Credit to allow small businesses to invest and plan for the future. Remember, Congressional inaction can cause as much harm as acting and nowhere have those negative effects been felt more than by the small businesses on Main Street.

Thank you for the opportunity to testify before you today on this important issue.



Statement for the Record for Associated Builders and Contractors

Testimony of
Rich Shavell

Before the
House Small Business Committee
Subcommittee on Economic Growth, Tax and Capital Access

On
"Tax Extenders and Small Business as Employers of Choice"

December 3, 2015

The Voice of the Merit Shop®

Thank you for the opportunity to appear today in front of your Committee. My name is Rich Shavell, and I am testifying today on behalf of Associated Builders and Contractors (ABC), a national construction industry trade association with 70 chapters representing nearly 21,000 chapter members. I am President of Shavell & Company, P.A., a full service CPA and consulting firm that focuses on services to closely-held commercial contractors. These are the general contractors, subcontractors, highway, and infrastructure contractors who build many of the great projects in South Florida and Southeastern United States.

The subject of this hearing is highly appropriate, as small businesses are indeed the employer of choice for the average American, not only within the commercial construction industry, but throughout the US economy as a whole. They provide the engine for economic growth and job creation, and reflect the spirit of free enterprise in its most basic form. Moreover, small businesses, particularly small contractors are excellent employers for several reasons:

- First, there is plenty of opportunity for workers choosing a career in commercial construction because the industry currently faces a labor shortage. I recently met with a small contractor who must turn down work because he cannot field sufficient numbers of qualified workers—and he is not alone.
- Secondly, training is available for new workers to the industry and in most cases these individuals do not even need to pay for apprenticeship training if they meet certain employment requirements.
- Third, there is excellent money for workers pursuing a career in the commercial construction industry. Via the ABC Institute (www.WeTrain.org) in South Florida, the Department of Labor has quantified the value of being a graduated Registered Apprentice at over \$300,000 during the career of the typical workers.ⁱ
- Fourth, the construction industry fosters the realization of the American Dream. The majority of the owners of my clients started out in the field working for someone else. Through effort and determination many construction workers find themselves picking-up small jobs and working them with their peers after hours and on weekends. Anecdotal evidence suggest that seasoned workers can earn significant amounts of money this way until they are ready to leave their regular position to pursue their own businesses on a full-time basis.

The term small business can be parsed in many ways, be it number of employees, amount of annual revenue, or any number of other metrics, but perhaps the most useful proxy is the use of pass-through entities. The pass-through structure is the simplest, most straightforward option for small, closely-held and family-owned Main Street businesses that have little use for the capital markets. As a result, according to a 2011 study by Ernst & Young, nearly 95 percent of all US businesses are structured as pass-through entities.ⁱⁱ These pass-through businesses generate 54 percent of all net business income, and employ 54 percent of all private sector employees.ⁱⁱⁱ

In other words, small business is the employer of choice for most Americans because that is simply where the jobs are. According to the Small Business Administration, small businesses account for nearly two thirds of all net new jobs.^{iv} Construction is no different- according to Tax Foundation analysis of US Census data, the 94 percent of contractors structured as pass-through entities employ over 75 percent of the more than 7.5 million workers employed in the industry.^v And, as noted above, given the inherently entrepreneurial bent of the skilled trades, today's laborer or independent contractor is likely to be tomorrow's small business employer.

The single biggest challenge facing small business today is widespread uncertainty- uncertain economic prospects, an uncertain regulatory environment, and uncertain tax policy. While the Congress can't very well control the ebb and flow of the business cycle, it can and must do better to relieve the self-inflicted economic constraints caused by regulatory overreach and anti-growth tax policies.

After years of Congressional showdowns and kicking the can on marginal tax rates, business owners finally get some needed tax certainty in 2013 when the "fiscal cliff" ended in permanent policy for the first time in over a decade. Unfortunately for the pass-through community, certainty is no salve for onerous tax policy. The terms of the fiscal cliff agreement took a 35 percent top rate on pass-through businesses, one that mirrored the C-Corp rate, and raised it to 39.6 percent. With the coincidence of Affordable Care Act implementation (and its associated taxes) in the same year, the combined marginal rate for many Main Street businesses surged nearly 25 percent higher than that faced by the Fortune 500. This sudden structural disadvantage gives a window into why permanence must not be an end goal in and of itself- first and foremost the aim must be to set prudent tax policy that helps the economy and its key driver, the small business.

We ask Congress to now take a step in that direction - of prudent tax policy - by rectifying a problem it put in place almost 30 years ago. In 1986 Congress passed legislation that was intended to curb abuses by aerospace and defense contractors and how they utilized the Completed Contract Method. The required use of the Percentage of Completion Method (PCM) was forced upon all businesses that perform construction services. There were a few carve outs, namely for home builders. But commercial contractors got the short end and have been increasingly paying for it ever since.

A "small contractor" exception was put in place in 1986 with a \$10 million average annual revenue threshold, demonstrating Congress' intent to shield these small businesses. Yet this figure was not indexed for inflation and almost 30 years later the threshold has never been updated. By comparison, the Small Business Administration's current standard puts the definition of a small contractor in certain construction categories at \$36.5 million. Congress needs to do three things:

1. First, update the small contractor threshold in section 460(e) from \$10 million to \$40 million;
2. Index the threshold going forward; and

3. Eliminate the Section 56(a)(3) add back requirement for Alternative Minimum Tax (AMT) purposes.

This third item eliminates the requirement that long-term contracts be reported under the PCM solely for AMT purposes. And a further horrific result is that the small contractor must then go through complex computations under the look-back method solely for AMT purposes. By eliminating the AMT adjustment, as we recommended, this onerous look-back requirement is eliminated for so many small businesses.

Next Congress needs to finally address the so-called tax “extenders,” the 52 tax provisions and incentives that expired at the end of 2014, just days after having been renewed retroactively. These assorted tax provisions have little in common, other than the fact that they are temporary, and now, having been lumped together at some point over the years, are presumed to be extended each year in perpetuity. The problem, of course, is that many (if not all) of these provisions are premised upon stimulating or otherwise incentivizing economic behavior, so unless enacted well in advance they yield diminishing returns. While Congress may be able to go back and retroactively extend tax policies to apply to the previous year, contractors don’t have the same luxury with their capital investments and business planning.

This year is a perfect example of the trouble with the current practice. As the year end approaches, the small business owner must project their 2015 taxes both with and without these tax provisions. They are left with a terrible choice: pay-in more taxes based on these laws not being effective or take the chance that the law will be passed. This is no way to do business, and the cash flow impact can limit expansion plans, force contraction, affect hiring decisions and even employee benefits that may or may no longer be available to employees.

Going back to the imperative of prudent tax policy, it is incumbent on Congress to go through these measures line by line to determine what belongs in the underlying tax code, and what should be allowed to expire or stand on its own merits, however temporarily, without hijacking the broader package.

The House has already done yeoman’s work in separating out broad based tax policies from rifle shot carve-outs, passing half a dozen key extender provisions on a permanent basis, and establishing a strong bipartisan agreement in favor of tax relief and certainty for small business. These bills include top priorities for ABC and the construction industry, in particular making permanent increased expensing under Section 179 and 50 percent bonus depreciation, respectively.

In a capital-intensive business such as construction, expensing and accelerated depreciation create a tremendous incentive to invest in equipment that might otherwise be cost prohibitive. The ability to write off up to \$500,000 in qualified purchases under Section 179 strongly encourages this sort of spending, while the precipitous drop to \$25,000 under current law (after the expiration of last year’s extenders bill) would have a disastrous effect, as cautious contractors opt to delay or forego these purchases altogether.

More cavalier counterparts, on the other hand, are stuck with big ticket items and an unexpected tax bill as they find themselves unable to utilize these anticipated accelerated deductions.

Likewise, traditional extenders such as the research and development (R&D) tax credit enjoy a wide, bipartisan consensus in Congress and should be made part of the permanent code. The R&D credit in particular has been extended 16 times since 1981, and is effectively viewed as part of the code, but in the meantime has turned into a must-pass vehicle for extraneous policy to attach itself to. Other sensible policies supported by contractors needlessly tied up in the extenders include:

- 15-year straight-line cost recovery for qualified leasehold, restaurant and retail improvements;
- the abbreviated five-year built-in gain holding period for S Corporations;
- the 179D deduction for energy efficient commercial buildings;
- Empowerment/Enterprise Zone Credits; and
- Work Opportunity Tax Credits

Small businesses are the employer of choice for most Americans, but without a commitment - and action - by Congress this status may be soon jeopardized. Congress needs to:

- End the annual extenders debacle and make permanent those provisions that belong in the underlying code.
- Fix the unfortunate and unintended accident of 1986 whereby all construction contractors regardless of size are now forced to report income under the percentage-of-completion method; and
- Address the recently inflated income tax rates that now befall profitable small businesses structured as pass-through entities.

Some of this can be done piecemeal, through easy fixes, such as reform of the small contractor definition under Section 460(e); others will require the political will to pass broad-based, fundamental tax reform. Until these issues are addressed, small business is playing with one hand tied behind its back.

ⁱU.S. Department of Labor. *Apprenticeship: Frequently Asked Questions*. <http://www.dol.gov/ap-prenticeship/faqs.htm>

ⁱⁱCarroll, Robert and Prante, Gerald. (April 2011). *The Flow-Through Business Sector and Tax Reform*. <http://www.s-corp.org/wp-content/uploads/2011/04/Flow-Through-Report-Final-2011-04-08.pdf>

ⁱⁱⁱIbid.

^{iv}Office of Advocacy, U.S. Small Business Administration. (September 2012). *Frequently Asked Questions about Small Business*. https://www.sba.gov/sites/default/files/FAQ_Sept_2012.pdf

^vPomerleau, Kyle. (January 2015). *An Overview of Pass-through Businesses in the United States*. http://taxfoundation.org/sites/taxfoundation.org/files/docs/TaxFoundation_SR227.pdf

**TESTIMONY BEFORE THE
SUBCOMMITTEE ON ECONOMIC GROWTH, TAX, AND
CAPITAL ACCESS**

**COMMITTEE ON SMALL BUSINESS
UNITED STATES HOUSE OF REPRESENTATIVES**

**Thomas J. Nichols, J.D., CPA¹
December 3, 2015**

Representative Kelly, Ranking Member Velazquez and other members of the Subcommittee, thank you very much for the opportunity to testify today regarding the important role closely held businesses play as employers and in the American economy, as well as some of the governmental and regulatory challenges they face today.

I have been representing closely held businesses ever since I began practicing tax and business law in 1979. I have been a member (and a past Chair) of the ABA Tax Section's Committee on S Corporations since 1986 and am currently Chairman of the Board of Advisors of the S Corporation Association. I am also a long-standing member of the Board of Directors of the Business Law Section of the State Bar of Wisconsin, in which capacity I am heading up the Business Entity Modernization Package project to update the state's corporate, partnership and limited liability company statutes, which we are hoping to get introduced and enacted in the upcoming 2016 legislative session. The views expressed today are informed by and benefit from all of those business and professional activities.

A. Overview

Let me begin by saying that I sincerely appreciate the bipartisan support private enterprise enjoys in the U.S. Congress. I know there are many divisive issues confronting Congress these days, but the important role Main Street Businesses play in the economy and in creating jobs is not one of them. This is for good reason. Today's closely held businesses employ most of the private sector workforce, and are the primary force in creating new jobs in the United States.

In addition, I can say from personal experience that small, closely held businesses often provide an atmosphere of loyalty and mutual respect that simply cannot be replicated in bigger firms. Owners and employees of small firms often perceive themselves as part of an extended family. Though the owners and the employees may not always make as much as their publicly held counterparts, they are often happier in this more welcoming setting. At the same time, such

¹ President and Shareholder, Meissner Tierney Fisher & Nichols S.C.

businesses typically do not have the financial wherewithal to absorb and comply with many of the regulatory burdens discussed below.

Smaller firms also provide an important safety net of job stability and diversity within the U.S. economy. Just as investors should seek to diversify their portfolios to mitigate the impact of unexpected negative developments affecting specific companies and sectors, public policy should seek to foster a broad variety of business enterprises. Not only does this help protect against regional and sectorial downturns, it also affords security and opportunity to individual employees that only multiple employment alternatives can provide.

Finally, as any economist will tell you, there is no better way to foster innovation and progress in an economy than by having numerous and different business enterprises competing to provide goods and services to their customers. A broad enterprise base, spread across the country, is infinitely superior to concentrating activity within a relatively few extremely large employers. Public policy should seek to encourage this diversity by removing barriers to the establishment, growth and survival of smaller firms and startups.

The S corporation is a successful example of this type of policy. The S corporation was created back in 1958 in an attempt to encourage family and closely-held businesses. It combined the liability protection of C corporations with the single layer of tax enjoyed by partnerships and sole proprietorships. Today, there are 4.6 million S corporations and they are located in every community and every sector of the economy. The S corporation is doing exactly what Congress intended, and its single-layer tax structure should be made the foundation of any tax reform effort moving forward.

The remainder of this written testimony highlights certain problem areas affecting closely held businesses, including late passage of extenders legislation, section 409A and not allowing employees to reimburse employees for individual market premiums.

B. Main Street Businesses as Employers

Any discussion of the U.S. economy needs to focus on jobs. And any discussion of jobs needs to start with Main Street Businesses. Let me emphasize three key facts to make this point.

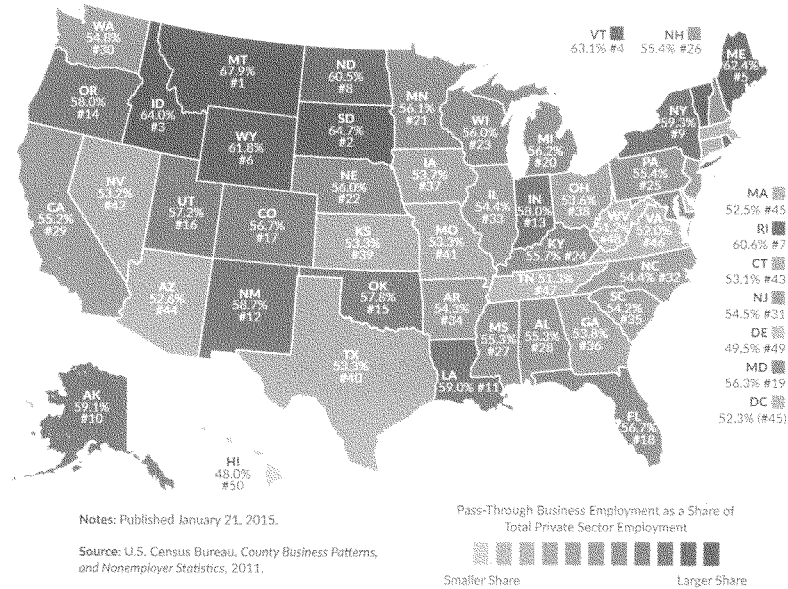
First, everybody in public policy has heard that small businesses create the majority of new jobs in our economy. The number varies from year to year but, even adjusting for statistical challenges and other concerns, studies of job creation have consistently found that smaller firms create the majority of new jobs in the United States.²

Second, this job creation adds up. As we know from the S Corporation Association's work with the Tax Foundation, today the majority of private sector workers wake up every morning and go to work at a business taxed as an S corporation, partnership, LLC, or sole proprietorship. These businesses today employ 11 out of 20 workers. In some states, like Maine and Montana, they employ 14 out of 20.

² Neumark, Wall, and Zhang (2011)

Figure 7. Pass-through Businesses Account for Most Private Sector Employment in Nearly all States

Pass-through Business Employment as a Share of Total Private Sector Employment, 2011



3

Third and finally, what may be less understood but critically important is the role “startup” businesses play in all that job creation. On this front, the Kaufman Foundation has done some important work demonstrating that *all* net job creation in the US economy comes from startup businesses. As they reported back in 2010, “without startups, there would be no net job growth in the U.S. economy.”

In summary, smaller employers represent the largest portion of the job base; they got that way by consistently creating the most jobs; and a critical source of that job creation is the startup sector and the millions of new jobs they contribute to the economy every year. So when it comes to job creation and employment, any conversation about growing the job base needs to start with the priorities of Main Street Businesses.

The challenge for policymakers is that business startup activity has *declined* sharply in recent years, with the percentage of new firms falling from 16 percent of all firms in the late

³ <http://taxfoundation.org/article/overview-pass-through-businesses-united-states>

1970s to just 8 percent in 2011.⁴ The decline is even greater in the last decade, with the most recent Census Bureau data available from 2011 showing that Americans created 27% fewer businesses that year than in 2006.⁵ Thus, the critical role of Main Street Businesses in creating and maintaining the job base is not guaranteed. Without start-ups and growing small businesses, the job-creating engine of the American economy could come to a halt.

To help facilitate the continued growth of start-ups and smaller employers, there are a number of things that Congress could do. My testimony will focus on some specific challenges that closely held businesses face today that Congress could address in ways that could help to reverse this trend and enable private and startup businesses to resume their critical role as a source of jobs, innovation and growth.

C. Unnecessary Impediments

Although there are undoubtedly many more items that could be listed, I will focus on a limited number of issues that regularly arise in my practice where compliance with the income tax system is made much more difficult for closely held businesses without any apparent offsetting positive revenue impact for the government.

1. Late Passage of Extenders

In recent years, an increasing number of significant tax code provisions have been extended on a year-to-year basis, rather than being incorporated permanently into the Internal Revenue Code. Many of these provisions are of critical importance to small business, including being able to expense up to \$500,000 of capital expenditures (rather than just \$25,000) each year, applying a five-year (rather than ten-year) built-in gains tax period and allowing a 15-year (rather than a potentially 39-year) recovery period for qualified leasehold property, qualified restaurant property and qualified retail improvements (“qualified property”).⁶ Fifty percent bonus depreciation also falls into this category, though it is less critical for smaller businesses if the section 179 and qualified property provisions are extended.

The purpose of most of these provisions is to incentivize businesses to make capital expenditures to improve productivity (which historically has been a prerequisite to increased wages) and to otherwise grow their companies and the economy. And while these provisions are listed as “tax expenditures,” I would argue that they are not. Rather, they much more effectively match the timing of taxation with the actual realization of income.

To use a simple example, suppose a small business owner has \$100,000 of cash left after paying all of his or her expenses during the year, and decides to invest that money in a machine that the owner hopes will raise the incomes of both the owner and his or her employees in the upcoming years. It is important to recognize that, when making this decision to forgo personal consumption and invest in the business, the owner has no assurance that those hopes will be

⁴http://www.kauffman.org/~media/kauffman_org/resources/2014/entrepreneurship%20policy%20digest/september%202014/entrepreneurship_policy_digest_september2014.pdf

⁵ <http://fivethirtyeight.com/features/the-slow-death-of-american-entrepreneurship/>

⁶ I.R.C. §§ 179, 1374, 168(e)(3)(E).

realized. The owner is taking a risk. It is just as important to realize that the \$100,000 will be income to another business and taxed as such. Finally, and most pressing, the business owner now has no money left to pay any tax on the income the owner has yet to receive from this new investment, and maybe never will. In this example, expensing more accurately reflects the true income of the business.

Given the substantial policy considerations underpinning these expensing provisions, there is no excuse for repeatedly delaying their extension until after the investment period. It works at cross purposes with the desired policy benefits, and it creates a dynamic where businesses must overpay their taxes during the course of the year, draining them of capital.

Delaying confirmation of the five year built-in gains tax period has similarly destructive consequences. In the past several years, small business owners have asked me repeatedly whether the five-year or ten-year period will apply. The only response I could give them is that the final built-in gains period will “probably” be five years, but that they can’t count on it. This has created a number of excruciatingly difficult situations for my clients. For example, several of my farming clients were attempting to sell agricultural land – either to raise capital or to finance their pending retirement – while farmland prices were at their peak. Unfortunately, for those in the critical 6 to 10-year “limbo” period, this uncertainty constituted a huge stumbling block, and now it appears that the optimal time for selling is gone.

I had another client who wanted to sell his business, but could ill afford to do so if the double-tax built-in gains regime was applicable. I recommended that he and the buyer reach agreement and have all the documents prepared, but wait until actual passage of the extenders legislation to sign and close the deal. His response was that he was in poor health and may not be able to wait.

As with expensing, a five-year period for the built-in gains tax is well supported by policy considerations. The built-in gains tax was originally enacted in the Tax Reform Act of 1986 and was intended to prevent C corporations from converting to S Corporation status and selling some or all of their business subject only to the single-tax S Corporation regime. To be honest, I have never understood why paying only one tax upon the sale of a business was considered a loophole to be closed. Regardless, it is generally recognized that a ten-year waiting period is much longer than necessary in order to achieve the initial policy goal. Given the uncertainties and vagaries of conducting business, business owners are extremely unlikely to elect S Corporation status with concrete plans to sell after waiting for a period of five or more years.

The expensing and built-in gains tax provisions are clearly supported by policy considerations, and should be permanently incorporated into the Internal Revenue Code. There is simply no good policy reason for repeatedly extending them for a year or two only. Absent permanence, at the very least Congress needs to get back into the habit of extending these provisions before they expire rather than after, and for multiple years at a time.

2. Section 409A and Deferred Compensation

Another example of an unforced error in our income tax system is section 409A of the Internal Revenue Code. It imposes rigid guidelines for deferred compensation plans, violation of which triggers substantial penalties on employees, including a 20 percent penalty tax (on top of the already substantial federal and state income tax) plus interest (at the overpayment rate +1 percent) for the entire period during which income was deferred, even though the corresponding income tax deduction to their employers has also been deferred.

The “abuse” this provision was intended to prevent is the postponement of taxable income attributable to deferred compensation paid to employees. However, this analysis failed to take into consideration the fact that that same deferral also postponed the corresponding tax deduction to the employees’ employers.⁷ For most closely held business enterprises, the tax benefit being postponed for the employer is actually greater than the tax cost for the employee. As you can imagine, closely held employers therefore almost never adopt these plans in order to achieve untoward tax benefits. In fact, they are nearly always adopted in order to achieve perfectly legitimate business objectives (e.g., conservation of scarce cash resources, continued employee stake in the ongoing concern, etc.).

Section 409A creates an unnecessary impediment to accomplishing those objectives. For example, in our practice, we have had to restate Phantom Stock Plan documents in order to comply with these new rules, notwithstanding the fact that the net effect of such plans effectively deferred deductions to S Corporation owners that were worth more than any tax savings enjoyed by their lower-income employee beneficiaries. Some of our clients have simply decided not to adopt perfectly legitimate deferred compensation vehicles in light of the additional complexity imposed by these new rules.

This provision represents such poor policy that the full American Bar Association Section of Taxation has come out against it.⁸

3. Employer Funding of Individual Policies

You might have thought that the Affordable Care Act should not constitute a serious regulatory impairment for very small businesses who do not qualify as “applicable large employers” (50 or more employees). Unfortunately, this is not the case. The Affordable Care Act is being implemented in a way that has serious negative consequences for even very small enterprises.

⁷ I.R.C. § 404(a)(5).

⁸ Letter on behalf of ABA Section of Taxation to William M. Thomas, Chairman of House Committee on Ways and Means; Charles E. Grassley, Chairman of Senate Committee on Finance; Charles B. Rangel, Ranking Member of House Committee on Ways and Means; and Max S. Baucus, Ranking Member of Senate Committee on Finance (July 31, 2006).

The Internal Revenue Service has taken the questionable position that Health Reimbursement Arrangements (“HRAs”), Employer Payment Plans (“EPPs”) and Health Flexible Spending Arrangements (“Health FSAs”) somehow run afoul of the market reform provisions of the Affordable Care Act when an employer reimburses its employees for premiums on health insurance purchased in the individual market. The explanation given is that such plans violate the “no annual limit” and “preventive services” Affordable Care Act requirements, notwithstanding the fact that the individual policies so procured do and are required to comply in full with those (and all other) Affordable Care Act requirements. The weakness of this position is further belied by the fact that, in the same announcement, the Service took the position that employer HRAs could reimburse employees for premiums on coverage offered by the same or even other employers. The bottom line is that an employer can’t reimburse his or her employees for premiums for insurance purchased in the individual market, but the employer can reimburse them for the cost of coverage provided by the employer or by other employers.⁹

This contorted position is particularly burdensome for small, closely held businesses who simply are not in a position to establish self-insured plans that can be tailored to meet employer and employee needs. As a consequence, a disproportionate number of our smaller clients have been negatively impacted. One client of ours had a health insurance plan that differed from what many of his employees preferred. In order to accommodate their concerns, he had established a long-standing HRA that provided generous reimbursement for premiums on health insurance policies selected by the individual employees. Both he and his employees liked this plan, but unfortunately, under the above-described IRS interpretation, they couldn’t keep it.

I have been surprised by how widespread the negative reaction to this IRS position has been. In fact, without specifically raising this issue, I’ve been contacted by practitioners, both in my capacity as Chairman of the Board of Advisors for the S Corporation Association as well as in my capacity as a member of the Board of Directors of the Business Law Section of the State Bar of Wisconsin, questioning how the Service could have reached such a result. At the national level, the National Federation of Independent Business has conducted research on how prevalent this problem is. NFIB concluded that “[c]urrently, 16 percent of small employers are in violation of the new rule.”

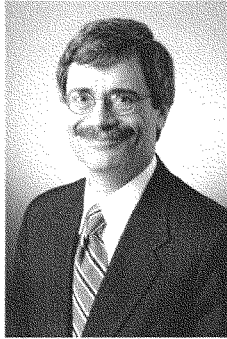
The penalties for running afoul of this questionable position are draconian. Having an HRA that allegedly violates the Affordable Care Act “no annual limit” and “preventive services” requirements results in a penalty of \$100 per day per employee (\$36,500 per year). Thus, a small employer with only 10 employees covered by his HRA could be facing a penalty of \$365,000 in any given year, all for just reimbursing those employees for the premiums on policies that are fully compliant with those and all other Affordable Care Act requirements. Such awkward and onerous requirements and penalties unavoidably serve to dampen entrepreneurial spirit for small business owners who cannot afford to hire and maintain expensive compliance departments.

⁹ See Notice 2013-54, Q&A 4, 6; I.R.S. Letter 2014-0039 (Sept. 22, 2014); I.R.S. Letter 2014-0037 (Sept. 22, 2014);

Fortunately, I am not the only person raising this issue. In fact, there is currently bipartisan legislation in both the House and the Senate to correct this interpretation.¹⁰ I would urge you to accelerate the passage of this bill, perhaps as part of the extenders legislation.

Once again, I would like to thank Representative Kelly and Ranking Member Velazquez for holding this hearing and inviting me to testify. As someone integrally involved in the day-to-day concerns of small and closely held businesses, I sincerely appreciate any and all efforts you undertake to alleviate the unnecessary governmental burdens that they now face.

¹⁰ Small Business Healthcare Relief Act, H.R. 2911, 114th Cong. (1st Sess. 2015); Small Business Healthcare Relief Act, S. 1697, 114th Cong. (1st Sess. 2015).

CURRICULUM VITAE

Thomas J. Nichols is a shareholder in the Milwaukee law firm of Meissner Tierney Fisher & Nichols S.C., where he has been practicing corporate and tax law since 1979. The firm itself is over 160 years old, and is the second oldest firm in the state of Wisconsin. Mr. Nichols represents a wide array of clients ranging from start-ups, physician group, software, publishing, sales, restaurant, real estate and other closely-held concerns to insurance company, manufacturing and mutual fund advisory clients.

Mr. Nichols is Chairman of the Board of Advisors of the S Corporation Association and a recent Chair of the S Corporations Committee of the ABA Section of Taxation, on which he has been active since 1987. In this capacity, Mr. Nichols has participated, as primary draftsman or otherwise, in the preparation of the Committee's comments on the large majority of regulations that have been promulgated by the Treasury to implement the current S corporation provisions enacted in the Subchapter S Revision Act of 1982 and subsequent legislation, including those concerning pass-through income and loss, adjusted basis, corporate accounts, the single class of stock requirement, open account indebtedness, qualified subchapter S subsidiaries, the built-in gains tax, passive income, self-employment tax, back-to-back loans, the new net investment income tax and other S corporation rules. Mr. Nichols has also worked with House and Senate legislators and staff personnel on pending Tax Reform efforts, and has been a member of various ABA Tax Section Task Forces dealing with tax reform, including assisting in the preparation of its August 3, 2006 Comments on Additional Options to Improve Tax Compliance Prepared by the Staff of the Joint Committee on Taxation (for which he was listed as the contact person for S corporations). Mr. Nichols also participated extensively in Wisconsin's federalization of its S corporation statutes, where a number of his recommendations were adopted as statutory amendments. In addition, at the request of the Wisconsin Department of Revenue, Mr. Nichols reviewed and revised drafts of the Department's Publication 102, "Wisconsin Tax Treatment of Tax Option (S) Corporations and Their Shareholders," both in 1987 and again in 1998.

Mr. Nichols has also been and is actively involved in the development and updating of Wisconsin's business entity statutes, including the adoption of provisions on cross-species mergers and conversions between corporations, partnerships, limited liability companies and non-profit corporations, as well as Wisconsin's current Business Entity Modernization Package designed to update and improve the State's partnership, limited liability company and corporate statutes. He is a member of the Board of Directors of the Business Law Section of the State Bar of Wisconsin and Chair of its Partnerships Committee, as well as a Member and Past Chairman of the Wisconsin Taxation Committee of the Wisconsin Institute of Certified Public Accountants. Mr. Nichols is also the columnist for the Journal of Passthrough Entities published by CCH, Incorporated; a "Choice of Entity" member of the National Health Lawyers Association and a Fellow of the American College of Tax Counsel.

Mr. Nichols has spoken and written extensively on tax and business entity topics, including testimony before various committees of the U.S. House of Representatives, the ABA Tax Section, the New York University Institute on Federal Taxation, the American Law Institute-American Bar Association (ALI-ABA), the Accounting Continuing Professional Education Network (ACPEN), the Tulane Tax Institute, the State Bar of Wisconsin, the Wisconsin Institute of Certified Public Accountants, the Corporate Practice Institute and numerous other groups and institutions. Mr. Nichols is AV-rated by Martindale-Hubbell, and has been selected for inclusion in the *Best Lawyers in America*® and *Super Lawyers*® publications.

